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TAGS: EFIN ECON GH
SUBJECT: GHANA CENTRAL BANK'S HALF YEAR 2005 ANAYSIS OF THE ECONOMY

Summary

¶1. The Bank of Ghana (BoG) issued its half year economic review and analysis of financial and monetary policies. Inflation declined to 15.7% in June, monetary growth slowed, interest rates and commercial lending rates are falling, remittances are almost 60% higher than in 2004, reserves are steady, and the cedi is stable. Tax revenue was above target, but the GoG missed budget targets due to delayed donor flows. Despite lower cocoa prices and higher oil prices, the BoG's outlook is positive. End Summary

Monetary and Financial Developments

¶2. The BoG noted that inflation continued to decline in the second quarter following the spike in February due to the 50% increase in fuel prices. Consumer price inflation fell for the third consecutive month from 16.7% in March to 15.7% in June on a year-on-year basis. The BoG's measure of core inflation (not including food or petroleum products) is in single digits.

¶3. The growth of monetary aggregates slowed in the second quarter, with reserve money and broad money (M2) both increasing as significantly lower rates than in the first quarter. Interest rates are broadly lower, following the BoG Monetary Policy Committee's (MPC) May 2005 decision to cut the Prime Rate from 18.5% to 16.5%. This decision has resulted in a realignment of rates. While the benchmark 91-day T-bill also declined by 2% to 15.5% in mid-July, the two and three year T-bills remained stable at 20% and 21.5% respectively and gained market share. This resulted in the lengthening of the average maturity of treasury bills, reducing the turnover rate of GoG securities to 1.9 times/year from 5 times/year in August 2004.

¶4. Commercial lending rates also fell to an average of 22.5% and credit to the private sector increased almost 16% from May 2004 to May 2005 (from 11.3% to 12.7% of GDP). (Note: Post's contacts in the banking sector say they often lend at much lower rates, especially to blue chip clients. End Note) Five sectors -- manufacturing, commerce, import financing, services, and transport, are falling, and credit to the private sector is up, accounted for 82% of credit flow. The BoG's July 1 decision to lower secondary reserve requirements on deposits from 35% to 15% should increase banks' liquidity and should result in more private sector lending.

Fiscal Developments

¶5. The GoG followed generally prudent fiscal policies for the first half, with total expenditures 14% below the budgeted level (although 25% above 2004 levels). However, delays in donor disbursements due to the late IMF third review of the Poverty Reduction and Growth Facility (PRGF), caused higher than expected domestic borrowing and the GoG missed its budget and net domestic financing targets. Tax revenue was 26% higher for the first half of 2005 compared to the similar period in 2004, and was the equivalent of about 20% of GDP. However, total grants amounted to under half of the expected 245 million. Overall the GoG's budget deficit was 1.56% of GDP, compared to an expected deficit of about 0.7%. Net domestic financing was approximately 1% of GDP, compared to the programmed net domestic repayment of about .2%.

External Sector Developments

¶6. Ghana is experiencing deteriorating terms of trade due to slightly lower cocoa prices and much higher oil prices. Also, the cedi has appreciated against the three core currencies -- Dollar, Pound, and Euro -- in nominal and real terms. Provisional Balance of Payments figures show that the balance on Ghana's merchandise trade for the half year worsened by over 60%. The overall BoP balance also showed a deficit ($285 million), which was financed by drawing down reserves. Gross international reserves declined from the end-2004 peak of $1.7 billion to $1.47 billion in June. However, this should rebound with expected donor flows and pending cocoa sales proceeds.

¶7. Total merchandise exports for the first half were 20% above the level for 2004. However, cocoa export proceeds

were significantly lower. The cocoa crop topped 700,000 tons for 2003/2004, but the expected 2004/2005 crop is 550,000 tons, and the average price is lower than in the previous season. (Note: 550,000 tons is still large in historical terms; much of the decrease is probably due to the GoG cracking down on smuggling from and trading with Cote d'Ivoire. End Note)

¶8. Ghana's merchandise imports increased over 30% over the first half, with oil imports increasing by 20%. (Note: BoG officials have commented that Ghana's oil bill is $500 million higher than when oil prices started there current rise several years ago -- or near total donor assistance. End Note) Private inward remittances (including individuals, NGOs, Embassies, religious groups) for January-May 2004 increased by 58.7% over the same period in 2004, totaling $1.6 billion.

Comment

¶9. Despite slightly deteriorating terms of trade due to lower cocoa prices and higher oil prices, relatively prudent fiscal and monetary policies support the BoG's positive outlook for the economy, with declining inflation, stable exchange rate, and opportunities for increased GDP growth. BoG sources acknowledge that continued high world oil prices are the main downside risk going forward, as they would restrain both Ghana's and the world's economic growth. Also, the GoG has yet to implement fully its petroleum deregulation scheme, which would allow retail prices to fluctuate in response to world price changes, thus ensuring full cost recovery. Until Ghana implements this plan, which is an important IMF condition, the government will continue subsidizing the petroleum sector, undermining fiscal policy. End Comment
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